Supreme Court, U.S.
FILED

SEP 27 2010

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No. 10- 10-422

IN THE

Supreme Court of the United States

IN RE: EXIDE TECHNOLOGIES,

Debtor.

EXIDE TECHNOLOGIES,

Petitioner,

v.

ENERSYS DELAWARE, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The Bankruptcy Code provides that a trustee or debtor in possession, "subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a). The Code, however, does not define "executory contract."

The Sixth and Eleventh Circuits have adopted a functional test for executoriness. Under the "functional test," the court focuses on the obligations remaining and will permit the rejection of contracts that impose burdensome and disadvantageous obligations on the bankruptcy estate, and the assumption of contracts that include rights that are beneficial and advantageous to the estate.

Conversely, seven circuits, including the Third Circuit in the instant action, have adopted a test focusing, not on whether the contract has remaining obligations, but instead on whether the nonperformance of those obligations would constitute a material breach. Under this "material-breach" test, no matter how onerous the remaining obligations or beneficial the remaining rights, if the breach of one party's obligations would not excuse the other party's performance, then the contract is not executory and not subject to rejection or assumption under the Code.

The question presented is:

Whether a contract that imposes continuing obligations on both parties, and which includes obligations that are burdensome and disadvantageous to the estate, is an executory contract subject to rejection under section 365(a) of the Bankruptcy Code.

PARTIES TO THE PROCEEDING BELOW AND RULE 29.6 STATEMENT

The parties to the proceeding in the United States Court of Appeals for the Third Circuit were Exide Technologies (the Petitioner here), and EnerSys Delaware, Inc. (the Respondent).

Pursuant to this Court's Rule 29.6, undersigned counsel state that Exide Technologies has no parent corporation and no publicly held company owns 10% or more of the stock of Exide Technologies.

TABLE OF CONTENTS

QUESTION PRESENTED i

PARTIES TO THE PROCEEDING BELOW AND RULE 29.6 STATEMENT ii

TABLE OF AUTHORITIES v

PETITION FOR A WRIT OF CERTIORARI 1

OPINIONS BELOW 1

JURISDICTION 1

STATUTORY PROVISIONS INVOLVED 1

STATEMENT 2

REASONS FOR GRANTING THE PETITION 13

I. THE THIRD CIRCUIT'S DECISION FURTHER EXACERBATED A WELL-DEVELOPED SPLIT AMONG THE FEDERAL COURTS OF APPEALS. 13

A. Circuits Adopting the Functional Test for Determining Whether a Contract is Executory. 14

B. Circuits Adopting the Material-Breach Test for Determining Whether a Contract is Executory. 17

II. THE MATERIAL-BREACH TEST IS INCONSISTENT WITH CONGRESSIONAL INTENT AND INJECTS AN ARBITRARY STATE-LAW ANALYSIS INTO AN AREA OF FEDERAL LAW THAT DEMANDS UNIFORMITY. 20

III. THE ISSUE IN CONFLICT IS IMPORTANT, RECURRING, AND WELL-PRESENTED BY THIS CASE. 25

CONCLUSION 28

APPENDIX A:
Opinion of the Court of Appeals 1a

APPENDIX B:
Opinion of the District Court 22a

APPENDIX C:
Opinion of the Bankruptcy Court 27a

APPENDIX D:
Order of the Court of Appeals
Denying Petition for Rehearing *En Banc* 84a

TABLE OF AUTHORITIES

CASES

Am. File Co. v. *Garrett*, 110 U.S. 288 (1884) 3

Dick ex rel. Amended Hilbert Residence Maint. Trust v. *Conseco, Inc.*, 458 F.3d 573 (7th Cir. 2006) 17

Hadden v. *Consol. Edison Co.*, 312 N.E.2d 445 (N.Y. 1974) 11, 24

In re Baird, 567 F.3d 1207 (10th Cir. 2009) 17

In re Becknell & Crace Coal Co., 761 F.2d 319 (6th Cir. 1985), *cert. denied sub nom.*, *Sloan* v. *Hicks*, 474 U.S. 1006 (1985) 14, 15, 16

In re Columbia Gas Sys., Inc., 50 F.3d 233 (3d Cir. 1995) 8, 18

In re Craig, 144 F.3d 593 (8th Cir. 1998) 17

In re Drexel Burnham Lambert Group, Inc., 138 B.R. 687 (Bankr. S.D.N.Y. 1992) 20

In re Exide Techs., 340 B.R. 222 (Bankr. D. Del. 2006), *aff'd*, No. 06-cv-302, 2008 WL 522516 (D. Del. Feb. 27, 2008), *vacated*, 607 F.3d 957 (3d Cir. 2010) 12

In re G-N Partners, 48 B.R. 462 (Bankr. D. Minn. 1985) 16

In re Gen. DataComm Indus., Inc., 407 F.3d 616 (3d Cir. 2005), *cert. denied sub nom.*, *Gen. Datacomm Indus., Inc.* v. *Arcara*, 546 U.S. 1031 (2005) 17, 18

In re Gen. Dev. Corp.,
84 F.3d 1364 (11th Cir. 1996) 16, 17, 22

In re Int'l Fibercom, Inc.,
503 F.3d 933 (9th Cir. 2007) 17

In re Jolly,
574 F.2d 349 (6th Cir. 1978),
cert. denied, 439 U.S. 929 (1978) 14

In re La Electronica, Inc.,
995 F.2d 320 (1st Cir. 1993) 19, 20

In re Liljeberg Enters., Inc.,
304 F.3d 410 (5th Cir. 2002) 17

In re Magness, 972 F.2d 689 (6th Cir. 1992) 15

In re Martin Bros. Toolmakers, Inc.,
796 F.2d 1435 (11th Cir. 1986) 15, 16

In re Murexco Petro., Inc.,
15 F.3d 60 (5th Cir. 1994) 21

In re Norquist,
43 B.R. 224 (Bankr. E.D. Wash. 1984) 22

In re Penn Traffic Co.,
524 F.3d 373 (2d Cir. 2008) 19

In re Sunterra Corp.,
361 F.3d 257 (4th Cir. 2004) 17

In re Waldron,
36 B.R. 633 (Bankr. S.D. Fla. 1984) 16

In re Wegner, 839 F.2d 533 (9th Cir. 1988) 19

In re Wireless Data, Inc.,
547 F.3d 484 (2d Cir. 2008) (per curiam) 25

Lubrizol Enters., Inc. v. *Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), *cert. denied*, 475 U.S. 1057 (1985) 27

N.C.P. Mktg. Group, Inc. v. *BG Star Prods., Inc.*, 129 S. Ct. 1577 (2009) 25

Nichols v. *United States*, 384 U.S. 678 (1966) 21

NLRB v. *Bildisco & Bildisco*, 465 U.S. 513 (1984) ..21

Ohio v. *Kovaks*, 469 U.S. 274 (1985) 4

Ry. Labor Executives' Ass'n v. *Gibbons*, 455 U.S. 457 (1982) 22

Sackett v. *Spindler*, 248 Cal. App. 2d 220 (1967) 24

Sharon Steel Corp. v. *Nat'l Fuel Gas Distr. Corp.*, 872 F.2d 36 (3d Cir. 1989) 8, 18

CONSTITUTION

U.S. Const., art. I, § 8, cl. 4 22

STATUTES

11 U.S.C. § 101(5) 4

11 U.S.C. § 101(5)(B) 4

11 U.S.C. § 101(35A) 9, 27

11 U.S.C. § 365 .....3, 20, 27

11 U.S.C. § 365(a) 1, 2, 3, 5, 11, 13

11 U.S.C. § 365(b) 4

11 U.S.C. § 365(c) 4

11 U.S.C. § 365(c)(1) 25

11 U.S.C. § 365(d) 4

11 U.S.C. § 365(g) 3, 28
11 U.S.C. § 365(n) 27
11 U.S.C. § 365(n)(1)(B) 9, 10, 12, 27, 28
11 U.S.C. § 1107(a) 2
11 U.S.C. § 1141(d) 4
28 U.S.C. § 158(a)(1) 10
28 U.S.C. § 158(d)(1) 10
28 U.S.C. § 1254(1) 1
28 U.S.C. § 1291 10

OTHER AUTHORITIES

1 Bankruptcy Law Manual (5th ed. 2009) 26
2 Collier on Bankruptcy (15th ed. 1986) 3, 16
H.R. Rep. No. 95-595 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963 ..... 5, 20, 21
S. Rep. No. 95-989 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5844 ..... 4-5, 20, 21
S. Rep. No. 100-505 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200 28
Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439 (1973) ..... *passim*
William D. Warren & Daniel J. Bussel, *Bankruptcy* (6th ed. 2002) 26

PETITION FOR A WRIT OF CERTIORARI

Petitioner Exide Technologies respectfully petitions this Court to issue a writ of certiorari to the United States Court of Appeals for the Third Circuit to review the judgment in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 607 F.3d 957. The opinion of the district court (Pet. App. 22a-26a) is unreported but available electronically at 2008 WL 522516. The opinion of the bankruptcy court (Pet. App. 27a-83a) is reported at 340 B.R. 222.

JURISDICTION

The judgment of the court of appeals was entered on June 1, 2010. A timely-filed petition for rehearing *en banc* was denied on June 29, 2010 (Pet. App. 84a-85a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 365(a) of the Bankruptcy Code provides in full:

> Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

11 U.S.C. § 365(a).

Section 1107(a), which extends this authority to a debtor in possession in a reorganization proceeding under Chapter 11 of the Code, provides in full:

> Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

Id. § 1107(a).

STATEMENT

1. The Bankruptcy Code permits trustees and debtors in possession to maximize the value of the bankruptcy estate by rejecting contracts that are onerous and burdensome, and by assuming contracts that are beneficial and advantageous. *See* 11 U.S.C. §§ 365(a), 1107(a). Congress, however, limited this important power to "executory contracts" without defining that term.

a. A contract may be beneficial to a debtor rehabilitating its affairs in bankruptcy, or it may be burdensome. When the cost imposed by a contract's obligations exceeds the value of the benefits that the bankruptcy estate derives from that contract, continued performance can be burdensome, and in the converse situation, continued performance can be beneficial. The power of rejection and assumption

maximizes the value of the estate by allowing the trustee or debtor in possession to reject contracts that would otherwise burden the estate, and to assume contracts that would otherwise benefit the estate.

b. The option of the trustee or debtor in possession to reject or assume an executory contract stems directly from the trustee's long-standing power to abandon obligations burdensome to the estate—a court-made doctrine. *See* Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 440, 450 (1973); *see also* 2 Collier on Bankruptcy ¶ 365.01[1] (15th ed. 1986). Indeed, more than forty years before this Court recognized that assignees in bankruptcy have the power to abandon "property of an onerous or unprofitable character," *Am. File Co.* v. *Garrett*, 110 U.S. 288, 295 (1884) (relying in part on English practice), courts in England had concluded that this power included the option to abandon "worthless or onerous . . . leases and other executory contracts." Countryman, *supra*, at 440 (footnotes omitted).

In the mid-1930's Congress codified this power, expressly "authorizing assumption or rejection of executory contracts, including unexpired leases, of the bankrupt or debtor." Countryman, *supra*, at 439; *see also id.* at 447-48. Today, this power resides in section 365 of the Code. *See* 11 U.S.C. § 365(a).

i. Rejection relieves the estate of the obligations of performing under an executory contract by treating the rejection as a pre-petition breach by the debtor. *See* 11 U.S.C. § 365(g). Although rejection does not eviscerate the underlying contract, the estate is

relieved of the full cost of performing the debtor's remaining obligations. Instead, the estate generally only bears a portion of that cost, because the liability stemming from the rejection is treated as an unsecured "claim," *id.* § 101(5), and the other party is generally precluded from seeking specific performance, *see id.* § 101(5)(B); *see also Ohio* v. *Kovaks*, 469 U.S. 274, 278-79 (1985). Moreover, unless an exception applies, the liability is discharged upon confirmation of the plan, *see, e.g.*, 11 U.S.C. § 1141(d).

ii. Assumption, on the other hand, requires the estate to take on the debtor's obligations under an executory contract, but it allows the estate to obtain the benefits of the other party's continued performance. Accordingly, the trustee or debtor in possession will assume a contract, and thereby maximize the value of the estate, when the rights under the contract are more valuable than the cost of satisfying the contract's remaining obligations. But before the estate can assume an executory contract, the trustee or debtor in possession must cure any default under the contract, 11 U.S.C. § 365(b), and the estate's ability to assume the contract is subject to other limitations not relevant here, *see, e.g.*, *id.* § 365(c), (d).

c. Although Congress codified (and has placed certain limits on) the power of a trustee or debtor in possession to reject or assume an executory contract, it has never defined that term. Instead, Congress recognized that there is "no precise definition" of which contracts are executory, but that term "generally includes contracts on which performance remains due to some extent on both sides." S. Rep. No. 95-989, at 58 (1978), *reprinted in* 1978 U.S.C.C.A.N.

5787, 5844; *accord* H.R. Rep. No. 95-595, at 347 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6303.

2. This case turns on whether a particular agreement is an executory contract within the meaning of the Bankruptcy Code. The Petitioner, Exide Technologies, is one of the world's largest producers and recyclers of lead-acid batteries. On April 15, 2002, Exide filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Pet. App. 24a. Thereafter, Exide requested approval from the Bankruptcy Court to reject certain pre-petition contracts pursuant to section 365(a) of the Code, including a trademark license agreement, which permitted the Respondent, EnerSys Delaware, Inc., as the licensee, to use a trademark owned by Exide. Pet. App. 27a-30a. EnerSys opposed rejection, arguing, among other things, that the agreement was not an executory contract and, therefore, could not be rejected under section 365(a). *See* Pet. App. 27a-28a.

a. In June 1991, Exide sold substantially all of its industrial battery business to EnerSys, which was then known as Yuasa Battery (America), Inc. Pet. App. 28a-29a. As part of the transaction, the parties executed over twenty-three agreements, four of which collectively comprise the agreement at issue here (hereinafter, the "Agreement"). *Id.*[1]

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[1] The four agreements that collectively comprise the Agreement at issue here are: (1) the Trademark and Trade Name License Agreement, (2) the Asset Purchase Agreement, (3) the Administrative Services Agreement (each of which was dated June 10, 1991), and (4) a letter agreement (dated December 27, 1994). Pet. App. 28a-29a. The Bankruptcy Court found that these four agreements constituted a "fully integrated, un-

The assets that Exide sold to EnerSys as part of the transaction included physical manufacturing plants, equipment, and certain items of intellectual property, including certain specifically enumerated trademarks. Pet. App. 29a. In addition, certain Exide employees in the company's industrial battery division became EnerSys employees. *Id.*

Although Exide sold to EnerSys several specifically enumerated trademarks, it did not sell a mark related to its name, the EXIDE mark. Pet. App. 29a-30a. In fact, Exide expressly retained ownership, control, and possession of this mark, which it continued to use in connection with its ongoing battery businesses, including batteries for the transportation industry. *See id.*

Instead, as part of the Agreement, Exide contractually licensed to EnerSys the use of the EXIDE mark in specified areas of the industrial battery business, but the Agreement includes certain ongoing obligations. Pet. App. 30a. Specifically, EnerSys is obligated to: (1) refrain from using the EXIDE mark outside the industrial battery business; (2) maintain a minimum level of quality for its products that contain the mark; (3) indemnify Exide from and against certain costs, losses, liabilities, damages, lawsuits, and claims; and (4) cooperate with Exide after the closing of the Agreement to effectuate certain provisions contained therein. Pet. App. 34a-35a, 44a-53a. For its part, Exide continues to be obligated to: (1) refrain from suing EnerSys for trademark in-

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ambiguous document," Pet. App. 29a—a finding that neither party challenged in the Third Circuit. Pet. App. 4a.

fringement based on its use of the mark; (2) refrain from using the mark within specified parts of the industrial battery business; (3) maintain registrations of the mark; (4) make payments into a pension plan maintained for the benefit of the employees transferred under the Agreement; (5) indemnify EnerSys from and against certain costs, losses, liabilities, damages, lawsuits, and claims; and (6) cooperate with EnerSys after the closing of the Agreement to effectuate certain provisions contained therein. *Id.*

The Agreement also provides for termination in certain instances. Pet. App. 37a-39a. For example, Exide reserved the right to terminate the Agreement if EnerSys used the EXIDE mark outside the industrial battery business, or if EnerSys's products failed to satisfy the quality standards set forth in the Agreement. Pet. App. 38a. For the first nine years following the execution of the Agreement, both parties performed their respective, ongoing obligations arising out of the 1991 transaction without major dispute. Pet. App. 30a.

b. In 2000, Exide and EnerSys mutually agreed to the early termination of a ten-year non-compete agreement, thereby allowing Exide to re-enter the industrial battery business. Pet. App. 30a. Later that year, Exide purchased GNB Technologies Inc. (including GNB Industrial Battery Company) and returned to the North American industrial battery market in direct competition with EnerSys. *See id.*

Prior to and as Exide was poised to re-enter the industrial battery market—indeed, well before it filed for bankruptcy protection—Exide began a worldwide campaign to unify its image and brand

under a single mark. *Id.* Naturally, Exide wanted that mark to be EXIDE. *See id.*

c. When Exide filed for bankruptcy protection in 2002, it sought to reject a number of pre-petition contracts under section 365, including agreements relating to the EXIDE mark. Exide subsequently filed rejection notices for six pre-petition contracts, four of which comprise the Agreement at issue here. Pet. App. 27a-29a & n.3. EnerSys objected. Pet. App. 27a-28a.

3. a. The Bankruptcy Court, following eight days of hearings, issued an opinion and order approving Exide's rejection of the Agreement. Pet. App. 27a-83a.

i. The Bankruptcy Court explained that, "[i]n determining whether a contract is executory and, hence, subject to rejection, courts in [the Third] Circuit utilize the Countryman standard, which provides that a contract is executory when 'the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.'" Pet. App. 32a (quoting Countryman, *supra*, at 460, and citing *Sharon Steel Corp.* v. *Nat'l Fuel Gas Distr. Corp.*, 872 F.2d 36, 39 (3d Cir. 1989)). The Bankruptcy Court then distilled this test to its essence — whether "'both parties have unperformed obligations that would constitute a material breach if not performed'" at the time the bankruptcy petition was filed. *Id.* (quoting *In re Columbia Gas Sys., Inc.*, 50 F.3d 233, 239 (3d Cir. 1995)). Finally, the Bankruptcy Court explained that, under the Third Cir-

cuit's approach, it must apply the law of the state that governs the contract—in this case, New York law—to determine "whether the Agreement contained any material obligations." Pet. App. 33a.

ii. Applying these standards, the Bankruptcy Court held that the Agreement was an executory contract, and Exide could reject it. Specifically, the court concluded that: (1) the Agreement imposed material obligations on both parties, the breach of which would excuse the other party's performance, Pet. App. 33a-39a, 44a-53a; (2) those obligations were duties, not conditions, under New York law, Pet. App. 39a-44a; and (3) because "both parties had a number of material obligations under the Agreement . . . and, therefore, could not have rendered substantial performance," the breach of the Agreement by either party would not have excused the other party's performance under New York's substantial-performance doctrine, Pet. App. 53a.

iii. The Bankruptcy Court also held that rejection of the Agreement "leaves EnerSys without the right to use the Exide mark." Pet. App. 80a. Although the court recognized that, upon the rejection of an executory contract in which the debtor is a licensor of intellectual property, section 365(n)(1)(B) of the Code permits a licensee to retain its rights under the contract, this section did not spare EnerSys from the consequence of rejection because Congress expressly excluded trademarks from the definition of "intellectual property" used in that section. Pet. App. 78a-80a (citing 11 U.S.C. § 101(35A)). As a result, the Agreement was not subject to the special protections of section 365(n)(1)(B). *Id.*

b. EnerSys appealed to the District Court under 28 U.S.C. § 158(a)(1). Pet. App. 22a. Finding "no error of fact or law" in the Bankruptcy Court's "well reasoned and detailed opinion," the District Court affirmed. Pet. App. 24a-25a, 26a.

c. EnerSys then appealed to the United States Court of Appeals for the Third Circuit, invoking that court's jurisdiction under 28 U.S.C. §§ 158(d)(1) and 1291. Pet. App. 6a. In broad terms, EnerSys argued that the Agreement is not an executory contract, and that, in any event, Exide could not reject it. *See id.*

i. The Court of Appeals held that the Agreement is not an executory contract and vacated the judgment of the District Court. Pet. App. 3a. The Court of Appeals purported to apply the same "material-breach" test identified by the lower courts—specifically, "whether the Agreement, on [the date that the bankruptcy petition was filed], contained at least one obligation for both Exide and EnerSys that would constitute a material breach under New York law if not performed." Pet. App. 8a. But instead of determining whether the parties had at least one obligation continuing into the future, the Court of Appeals for the first time applied the equitable doctrine of substantial performance to determine whether the parties' past performance would not excuse the other party from performing its remaining obligations and, therefore, whether the contract was executory under the material-breach test. *See* Pet. App. 8a-12a.

According to the Court of Appeals, under New York law, "when a breaching party 'has substantially performed' before breaching, 'the other party's performance is not excused.'" Pet. App. 9a (quoting

Hadden v. *Consol. Edison Co.*, 312 N.E.2d 445, 449 (N.Y. 1974)). The court acknowledged that there is "'no simple test for determining whether substantial performance has been rendered,'" *id.* (quoting *Hadden*, 312 N.E.2d at 449), and that the "issue of whether a party has substantially performed is usually a question of fact," *id.* Nevertheless, the Court of Appeals held that (i) EnerSys had substantially performed under the Agreement, (ii) Exide's remaining performance would not be excused, and (iii) therefore the contract was not executory. Pet. App. 10a. Thus, the Third Circuit's approach invites courts to conclude that, no matter how onerous the remaining obligations or beneficial the remaining rights under a contract, if one party's performance rendered outweighs its performance remaining, the contract is not executory and is therefore not subject to rejection or assumption under the Bankruptcy Code. *See id.*

Moreover, in weighing EnerSys's remaining obligations under the Agreement, the Court of Appeals discounted any remaining obligation that it characterized as a condition subsequent under New York law, because the nonoccurrence of such a condition would not excuse Exide's remaining performance under that state's law. Pet. App. 11a. As a result, the Court of Appeals effectively concluded that conditions are not among the obligations that can be used to determine whether an estate can reject or assume a contract under section 365(a). *See id.*

ii. Judge Ambro joined the court's opinion in full, but filed a separate concurring opinion, in which he stated his disagreement with "the Bankruptcy

Court's determination, adopted by the District Court, that '[r]ejection of the Agreement leaves EnerSys without the right to use the Exide mark.'" Pet. App. 14a (quoting *In re Exide Techs.*, 340 B.R. 222, 250 (Bankr. D. Del. 2006)). Judge Ambro acknowledged that Congress did not include trademarks within the definition of intellectual property that could be retained under section 365(n)(1)(B), and he further acknowledged that this decision was intentional. Pet. App. 16a, 19a. In his view, however, "a trademark licensor's rejection of a trademark agreement under 11 U.S.C. § 365 does not necessarily deprive the trademark licensee of its rights in the licensed mark." Pet. App. 14a.

iii. Exide filed a timely petition for rehearing *en banc*, but the Court of Appeals denied that petition without opinion. Pet. App. 84a-85a.[2]

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[2] Shortly after the Third Circuit issued its order denying Exide's petition for rehearing *en banc*, Exide filed an adversarial proceeding against EnerSys in the Bankruptcy Court, seeking a declaration of its rights under the reorganization plan that the Bankruptcy Court had previously approved in this matter. *See Exide Techs.* v. *EnerSys Delaware, Inc.*, No. 10-ap-52766 (Bankr. D. Del.) (complaint filed Aug. 20, 2010). That proceeding remains pending before the Bankruptcy Court.

REASONS FOR GRANTING THE PETITION

I. THE THIRD CIRCUIT'S DECISION FURTHER EXACERBATED A WELL-DEVELOPED SPLIT AMONG THE FEDERAL COURTS OF APPEALS.

A well-entrenched conflict exists among the federal courts of appeals regarding the test used to determine what constitutes an "executory contract" under section 365(a) of the Bankruptcy Code—a term that Congress left undefined.

In an effort to fill this void, two federal courts of appeals—the Sixth and Eleventh Circuits—have adopted a functional test to determine executoriness. Under this functional approach, the court focuses on the remaining obligations owed by both parties and will permit the trustee or debtor in possession to reject contracts that impose burdensome and disadvantageous obligations on the bankruptcy estate, and assume contracts that include rights that are beneficial and advantageous to the estate.

In contrast, seven other circuits (including the Third Circuit in the instant action) have adopted a "material-breach" test, which Professor Countryman first articulated in a 1973 law review article. *See* Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973). Under this rigid test, the estate is denied the option of rejection or assumption, without exception, unless the contract imposes material obligations on both parties, the breach of which must excuse the other party's performance. And because this test looks to whether the other party's performance would be ex-

cused under state law, courts within these jurisdictions must engage in an extensive, state-law analysis into such questions as: (1) whether the obligation is a duty or condition under state law; and (2) whether the obligation satisfies the state's materiality standard.

In addition, the decision below now adds a third factor. Because the Third Circuit for the first time applied the equitable doctrine of substantial performance to determine whether a contract is executory, courts following the material-breach test also must engage in a fact-intensive inquiry into whether, notwithstanding the existence of material obligations on both sides, the performance that any party has rendered outweighs its remaining obligations.

A. Circuits Adopting the Functional Test for Determining Whether a Contract is Executory.

The Sixth Circuit was the first federal appellate court to adopt the so-called functional test for determining whether a contract is executory. *See In re Jolly*, 574 F.2d 349, 350-51 (6th Cir. 1978), *cert. denied*, 439 U.S. 929 (1978). As that court explained: "'The key, it seems, to deciphering the meaning of the executory contract rejection provisions, is to work backward, proceeding from an examination of the purposes rejection is expected to accomplish.'" *In re Becknell & Crace Coal Co.*, 761 F.2d 319, 322 (6th Cir. 1985) (quoting *Jolly*, 574 F.2d at 350-51), *cert. denied sub nom.*, *Sloan* v. *Hicks*, 474 U.S. 1006 (1985).

Under this straightforward approach, the focus becomes: (1) whether the contract imposes "obligations which continue into the future," and where the trustee or debtor in possession seeks to reject a contract, (2) whether that contract includes "an obligation for the debtor to do something in the future." *Id.* Thus, in *In re Becknell & Crace Coal Co.*, the Sixth Circuit held that the contract at issue (a lease-purchase agreement) "was executory" because the debtors "had obligations to perform in the future." *Id.*

The Sixth Circuit reaffirmed its adherence to the functional test in *In re Magness*, 972 F.2d 689 (6th Cir. 1992). In that case, the court acknowledged that the material-breach test—first proposed by Professor Countryman—was "helpful but not controlling in the resolution of what is an executory contract." *Magness*, 972 F.2d at 694. Instead, the court again stated that the proper analysis "work[ed] backward from an examination of the purposes to be accomplished by rejection," and if those purposes—namely, relieving the estate of onerous and burdensome obligations—can be accomplished through rejection, then the contract is executory. *Id.*

Following the Sixth Circuit's lead, the Eleventh Circuit first suggested its agreement with, and later adopted, the functional test. Beginning in *In re Martin Brothers Toolmakers, Inc.*, 796 F.2d 1435 (11th Cir. 1986), the Eleventh Circuit recognized, in *dicta*, the virtues of the functional approach:

> Section 365 enables the bankruptcy trustee to affirm or reject leases and executory contracts, and is based on the trustee's long-standing

> power to abandon obligations burdensome to the estate. *See* 2 Collier on Bankruptcy ¶ 365.01[1] (15th ed. 1986). Consequently, some courts have explicitly held that if a particular agreement is not unduly burdensome or is especially advantageous, it should not be construed as an agreement subject to § 365. *See, e.g., In re Becknell & Crace Coal Co.*, 761 F.2d 319 (6th Cir. 1985) (construing lease-purchase agreement of coal field); *In re G-N Partners*, 48 B.R. 462 (Bankr. D. Minn. 1985) (construing option to purchase reality); *In re Waldron*, 36 B.R. 633 (Bankr. S.D. Fla. 1984) (same).

Martin Bros., 796 F.2d at 1439.

Several years later, the Eleventh Circuit formally adopted the functional test in *In re General Development Corp.*, 84 F.3d 1364, 1365, 1374-75 (11th Cir. 1996). In that case, the debtor in possession sought to reject an agreement to convey property, but the other party opposed rejection, arguing that the underlying agreement was not an executory contract under Professor Countryman's material-breach test. *Id.* at 1375. The bankruptcy court, district court, and the Eleventh Circuit all disagreed. *Id.* at 1374. As the Eleventh Circuit's opinion explains: "While the concept of executoriness will no doubt engender additional debate in the future, this court finds no support in the Code itself or the legislative history of section 365 to apply as rigid a definition of 'executory' contract as [the appellant-creditor] would urge this Court to apply." *Id.*; *see also id.* ("this court as well as other courts and commentators have consis-

tently expanded the definition of 'executoriness' beyond the static definition articulated by Professor Countryman").

Under the Eleventh Circuit's approach, consistent with that of the Sixth Circuit, "the question of whether a contract is executory is determined by the benefits that assumption or rejection would produce for the estate." *Id.* at 1375. And because, in *General Development Corp.*, the debtor in possession's "ability to reject contracts which obligated it to improve and deed developed homesite lots was critical to its reorganization," the court held that the estate "was entitled to reject [the contract at issue] as an executory contract pursuant to Section 365(a) of the Bankruptcy Code." *Id.*

B. Circuits Adopting the Material-Breach Test for Determining Whether a Contract is Executory.

Seven other circuits—namely, the Third, Fourth, Fifth, Seventh, Eighth, Ninth, and Tenth Circuits—have adopted Professor Countryman's "material-breach" test. *See, e.g.*, *In re Gen. DataComm Indus., Inc.*, 407 F.3d 616, 623 (3d Cir. 2005), *cert. denied sub nom., Gen. Datacomm Indus., Inc.* v. *Arcara*, 546 U.S. 1031 (2005); *In re Sunterra Corp.*, 361 F.3d 257, 264 (4th Cir. 2004); *In re Liljeberg Enters., Inc.*, 304 F.3d 410, 436 (5th Cir. 2002); *Dick ex rel. Amended Hilbert Residence Maint. Trust* v. *Conseco, Inc.*, 458 F.3d 573, 577 (7th Cir. 2006); *In re Craig*, 144 F.3d 593, 596 (8th Cir. 1998); *In re Int'l Fibercom, Inc.*, 503 F.3d 933, 941 (9th Cir. 2007); *In re Baird*, 567 F.3d 1207, 1211 (10th Cir. 2009).

Under this rigid test, the court must determine whether "'the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.'" *Gen. DataComm Indus.*, 407 F.3d at 623 (quoting *Sharon Steel Corp.* v. *Nat'l Fuel Gas Distrib. Corp.*, 872 F.2d 36, 39 (3d Cir. 1989), which in turn quotes Countryman, *supra*, at 460). "Thus, unless both parties have unperformed obligations that would constitute a material breach if not performed, the contract is not executory under § 365." *In re Columbia Gas Sys. Inc.*, 50 F.3d 233, 239 (3d Cir. 1995). "The time for testing whether there are material unperformed obligations on both sides is when the bankruptcy petition is filed." *Id.* at 240. Moreover, in conducting this determination, the bankruptcy court must "consider contract principles under relevant nonbankruptcy law"—that is, under the state law that governs the contract at issue. *Id.* at 240 n.10.

Because the focus of this test is whether a hypothetical nonperformance by either party would excuse the other party's performance, the test pulls bankruptcy courts into such legal thickets as (1) whether a given obligation is a duty (the breach of which might excuse the other party's performance) or whether it is a condition (the nonoccurrence of which would not excuse the other party's performance), *e.g.*, *Columbia Gas*, 50 F.3d at 241-44 (engaging in a fact-intensive analysis regarding conditions and duties); and (2) whether a particular duty is a material or immaterial obligation (such that the nonperformance of that obligation would either excuse or not excuse

the other party's performance), *e.g.*, *In re Wegner*, 839 F.2d 533, 536-37 (9th Cir. 1988) (determining the materiality of obligations under Montana law, which required the court to analyze Montana cattle-branding statutes). Moreover, because the test requires bankruptcy courts to apply relevant nonbankruptcy law, the answers to these questions can vary, even within the same court, depending on which state's law applies. *See infra* Part II.

The material-breach test requires courts to resolve significant and difficult state law issues, but the opinion below further exacerbated these problems. Because the Third Circuit for the first time applied the equitable doctrine of substantial performance to determine whether a contract is executory, the court added to this traditionally forward-looking, material-breach test the backward-looking, fact-intensive test for substantial performance. Pet. App. 9a-10a (applying the substantial performance doctrine after acknowledging that there is "no simple test for determining whether substantial performance has been rendered," and further acknowledging that "whether a party has substantially performed is usually a question of fact").[3]

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[3] The First, Second, and District of Columbia Circuits apparently have not had occasion to decide which approach to adopt. *See, e.g.*, *In re Penn Traffic Co.*, 524 F.3d 373, 379 (2d Cir. 2008) (explaining that the court has "characterized an executory contract as one 'on which performance remains due to some extent on both sides,'" but acknowledging that the court has never resolved "the question of how much performance must be outstanding for the contract to be treated as executory under § 365"); *In re La Electronica, Inc.*, 995 F.2d 320, 322 (1st Cir. 1993) (declining to resolve whether the agreement at issue

II. THE MATERIAL-BREACH TEST IS INCONSISTENT WITH CONGRESSIONAL INTENT AND INJECTS AN ARBITRARY STATE-LAW ANALYSIS INTO AN AREA OF FEDERAL LAW THAT DEMANDS UNIFORMITY.

When Congress passed the Bankruptcy Reform Act of 1978, and thereby enacted section 365 of the Code, it was presumably aware of Professor Countryman's seminal 1973 article, which endeavored to define the term "executory contract." And yet, Congress left that term undefined, and expressed its belief that there was "no precise definition of what contracts are executory." S. Rep. No. 95-989, at 58 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5844; *accord* H.R. Rep. No. 95-595, at 347 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6303. Instead, calling for the kind of flexibility that is traditionally vested in courts of equity, the Senate and House Committee

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was an executory contract). However, at least one court within the Second Circuit has adhered to the functional approach and thoroughly explained the "psychedelic confusion" that strict adherence to the Countryman test has engendered. *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 687, 696-700 (Bankr. S.D.N.Y. 1992). And the First Circuit has expressly acknowledged the split among the circuits on this critical issue:

> Although the Bankruptcy Code does not define the term "executory contract," most courts adopt the position advanced by Professor Vern Countryman . . . . A few courts, treating Professor Countryman's definition as "helpful but not controlling," hold that the determination whether a contract is "executory" requires a more "functional" approach, "with an eye towards furthering the policies of the Bankruptcy Code."

La Electronica, 995 F.2d at 322 n.3 (citations omitted).

Reports both state that the term "*generally* includes contracts on which performance remains due *to some extent* by both parties." *Id.* (emphasis added); *see also NLRB* v. *Bildisco & Bildisco*, 465 U.S. 513, 522 n.6 (1984) (quoting this passage).

Contrary to this stated need for flexibility, the majority of the circuits have adopted—often with little or no analysis, *e.g.*, *In re Murexco Petro., Inc.*, 15 F.3d 60, 62 (5th Cir. 1994)—Professor Countryman's rigid, material-breach test, which focuses exclusively on whether one party's breach would excuse the other party's performance. The rigidity of this approach is not only contrary to Congress's statement that there is "no precise definition of what contracts are executory," but, more importantly, it can deny trustees and debtors in possession their traditional authority to shed onerous and burdensome obligations by requiring near-talismanic adherence to state-law standards that have nothing to do with federal bankruptcy policy. Indeed, whereas the policy behind Chapter 11 of the Bankruptcy Code is the "ultimate rehabilitation of the debtor," *Nichols* v. *United States*, 384 U.S. 678, 687 (1966), the material-breach test elevates form over substance. It focuses on questions of materiality, duties versus conditions, and substantial performance, instead of considering the critical issue of whether the estate would benefit from assuming or rejecting the contract's remaining obligations. Not surprisingly, then, the Eleventh Circuit could find "no support in the Code itself or the legislative history of section 365 to apply as rigid a definition of 'executory' contract" as the one first

advocated by Professor Countryman. *Gen. Dev. Corp.*, 84 F.3d at 1375.[4]

Just as troubling, the material-breach test's importation of state-law standards invites arbitrariness into an area of federal law that demands uniformity. The overarching purpose of the Bankruptcy Code is to carry out Congress's constitutional mandate to establish "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const., Art. I, § 8, cl. 4. The reliance on unrelated state-law standards undermines this purpose because the question of whether a particular contract is executory may vary, depending on which state's law applies, but the federal interest—whether a contract may be rejected or assumed—should not. The material-breach test leads to arbitrary results in an area that demands nationwide uniformity. *Cf. Ry. Labor Executives' Ass'n* v. *Gibbons*, 455 U.S. 457, 468 (1982) ("bankruptcy laws must be uniform throughout the United States").

Moreover, the combination of these two factors—the reliance on state law standards unrelated to federal bankruptcy law and policy, and the divergent results that can result depending on which state's law is applied—means that the test will often pro-

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[4] *Cf. In re Norquist*, 43 B.R. 224, 227 (Bankr. E.D. Wash. 1984) ("The logic of [the material-breach test] escapes me. I believe that the requirement of a remaining material obligation on the part of the nondebtor serves no useful purpose. It eliminates from the category of executory contracts some obligations which may prove extremely burdensome and, in some cases, obligations which may be prohibitive to the reorganization efforts of the debtor.").

duce results at odds with the stated purposes of the Bankruptcy Code. The present case is a prime example. The Third Circuit's reliance on the material-breach test allowed it to ignore the significant obligations that the Agreement continues to impose on both parties, including Exide's obligation to refrain from using a trademark bearing its own name in connection with a major segment of its business. *See* Pet. App. 34a-35a, 44a-53a. Whereas adherence to the functional test would have allowed the bankruptcy estate to shed this burdensome and onerous obligation, the Third Circuit's approach denied rejection because, under its reading of New York law, the other party's past performance outweighed its future obligations. *See* Pet. App. 9a-10a.

Finally, the material-breach test has proven itself unpredictable and difficult to apply. The state-law standards that it imports, for purposes of measuring materiality, typically require bankruptcy courts to engage in highly-subjective, fact-intensive analyses that demand the weighing of often competing factors. For example, the test for materiality under California law would require a bankruptcy court to consider:

> (1) The extent to which the injured party will obtain the substantial benefit which he could have reasonably anticipated; (2) the extent to which the injured party may be adequately compensated in damages for lack of complete performance; (3) the extent to which the party failing to perform has already partly performed or made preparations for performance; (4) the greater or less[er] hardship on the par-

> ty failing to perform in terminating the contract; (5) the wilful, negligent, or innocent behavior of the party failing to perform; and (6) the greater or less uncertainty that the party failing to perform will perform the remainder of the contract.

Sackett v. *Spindler*, 248 Cal. App. 2d 220, 229 (1967). Moreover, under the substantial-performance test that the Third Circuit imported into its executoriness analysis, a bankruptcy court would have to consider:

> [1] the ratio of the performance already rendered to that unperformed, [2] the quantitative character of the default; [3] the degree to which the purpose behind the contract has been frustrated, [4] the willfulness of the default, and [5] the extent to which the aggrieved party has already received the substantial benefit of the promised performance.

Pet. App. 9a (quoting *Hadden*, 312 N.E.2d at 449). At bottom, the tests for materiality and substantial performance invite highly subjective and divergent results, because the tests themselves are highly subjective and unpredictable.

The functional approach, however, does not suffer from any of these infirmities. The functional test is flexible and, therefore, consistent with congressional intent. In addition, the functional test is consistent with bankruptcy law's purpose of rehabilitating the debtor. It does not elevate form over substance; rather, it allows the estate to reject contracts whose combination of obligations and rights are onerous and burdensome, and assume contracts whose com-

bination of obligations and rights are beneficial and advantageous. Finally, the functional test leads to more consistent outcomes; it focuses on the obligations remaining under a contract, without characterizing the nature of those obligations under unrelated constructs of state law.

III. THE ISSUE IN CONFLICT IS IMPORTANT, RECURRING, AND WELL-PRESENTED BY THIS CASE.

The question of which contracts are executory is an issue of paramount importance for "Bankruptcy Courts and for businesses that seek reorganization" under the Code. *Cf. N.C.P. Mktg. Group, Inc.* v. *BG Star Prods., Inc.*, 129 S. Ct. 1577, 1578 (2009) (statement of Kennedy, J., in which Breyer, J., joined, regarding the denial of certiorari) (explaining that a split among the courts over the meaning of section 365(c)(1), which limits the power of the trustee or debtor in possession to assume an executory contract, "is an important one to resolve for Bankruptcy Courts and for businesses that seek reorganization"); *see also In re Wireless Data, Inc.*, 547 F.3d 484, 488 (2d Cir. 2008) (per curiam) (explaining that "assumption is an important re-organizational tool under Chapter 11"). The breadth of the definition of "executory contracts" determines which agreements are subject to assumption and rejection, and that, in turn, determines the trustee or debtor in possession's power to reject obligations that are onerous and burdensome, and to assume obligations that correspond with rights that are beneficial and advantageous. Thus, consistent with the doctrine's origins, whether a contract is executory defines the scope of the trus-

tee or debtor in possession's long-standing power to abandon liabilities burdensome to the estate and to maximize the recoveries available to the creditors.

This important question is also a recurring one. Indeed, it comes up in virtually every corporate reorganization case filed under Chapter 11 of the Bankruptcy Code, and to a lesser extent in cases filed under Chapters 7, 12, and 13. *See* William D. Warren & Daniel J. Bussel, Bankruptcy 247 (6th ed. 2002) ("Th[e] question [of executoriness] can arise in a Chapter 7 case as well as in all types of reorganization cases, but typically the issue arises in Chapter 11 cases . . . ."); *see also* 1 Bankruptcy Law Manual § 8:40 (5th ed. 2009) ("The power to assume or reject executory contracts is especially important in reorganization cases where it is used to relieve the debtor in possession of unperformed obligations that would otherwise hamper the debtor's opportunity to make a fresh start. Executory contracts and leases also may be rejected in chapter 7, chapter 12, and chapter 13 cases." (footnotes omitted)).

Finally, the question at issue is well-presented in this case. Indeed, this case turns on which test is applied. If the functional test applicable in the Sixth and Eleventh Circuits is adopted, then the Agreement is unquestionably executory in nature: It imposes obligations on both parties, and the obligations that it imposes on the estate are onerous and burdensome—particularly Exide's obligation to refrain from using a trademark bearing its own name in connection with a major segment of its business. *See* Pet. App. 34a-35a, 44a-53a. If, on the other hand, the material-breach test is applied, then under the

Third Circuit's analysis, the contract is not executory, because EnerSys's performance rendered outweighs its performance remaining. Pet. App. 9a-12a.

Moreover, a separate subsection of section 365 does not allow EnerSys to retain the right to use the EXIDE mark even after rejection and, therefore, does not provide an alternative ground for affirming the judgment below. To be sure, a provision of section 365(n) provides that, upon rejection of an executory contract in which the debtor is a licensor of "intellectual property," a licensee may elect to "retain its rights" under the license. 11 U.S.C. § 365(n)(1)(B). But Congress omitted from the definition of "intellectual property" trademarks, trade names, and other proprietary marks, *see id.* § 101(35A) (using the limiting term "means"—not the more expansive term "includes"—to define the forms of "intellectual property" covered by the definition, but not including within this exclusive list "trademarks" and other marks). According to the Senate Report that accompanied the passage of the legislation adding this provision, this decision was intentional:

> [T]he bill does not address the rejection of executory trademark, trade name or service mark licenses by debtor-licensors. While such rejection is of concern because of the interpretation of section 365 by [*Lubrizol Enterprises, Inc.* v. *Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), *cert. denied*, 475 U.S. 1057 (1985)], such contracts raise issues beyond the scope of this legislation. In particular, trademark, trade name and service mark licensing relationships depend to a large

> extent on control of the quality of the products or services sold by the licensee.

S. Rep. No. 100-505, at 5 (1988), *reprinted in* 1988 U.S.C.C.A.N. 3200, 3204.

As a result, if Exide, as debtor in possession, is entitled to reject the Agreement (which would occur if a "functional," rather than "material-breach," test were applied), then the rejection would "constitute[]" a breach, and EnerSys would be left with only an unsecured claim for monetary damages. *See* 11 U.S.C. § 365(g). In other words, because section 365(n)(1)(B) is not a viable alternative ground for affirmance, this case presents a compelling vehicle to resolve the question presented.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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September 27, 2010

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